PENSION MANAGEMENT OVERSIGHT COMMISSION

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MEETING MINUTES[1]

Meeting Date:	**September 14, 2000**
Meeting Time:	**10:00 A.M.**
Meeting Place:	**State House, 200 W. Washington St., Room 404**
Meeting City:	**Indianapolis, Indiana**
Meeting Number:	**2**

Members Present: **Rep. Thomas Kromkowski, Chairperson; Rep. Ron Liggett; Rep. Lawrence Buell; Sen. Joseph Harrison; Sen. Thomas Weatherwax; Sen. Larry Lutz; Mr. Steve Meno; Mr. William Gettings, Jr.**

Members Absent: **Rep. Richard Mangus; Sen. Allie Craycraft; Mr. Claude Davis; Ms. Connie Lux.**

Representative Kromkowski, the Chair of the Commission, called the meeting to order shortly after 10:00 a.m.

I. PERF and TRF Investment in Equities

Representative Kromkowski then recognized Mr. Bill Sheldrake, President of the Indiana Fiscal Policy Institute (IFPI), for a discussion of the impact of equity investments on Indiana's public pension funds.

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[1] Exhibits and other materials referenced in these minutes can be inspected and copied in the Legislative Information Center in Room 230 of the State House in Indianapolis, Indiana. Requests for copies may be mailed to the Legislative Information Center, Legislative Services Agency, 200 West Washington Street, Indianapolis, IN 46204-2789. A fee of $0.15 per page and mailing costs will be charged for copies. These minutes are also available on the Internet at the General Assembly homepage. The URL address of the General Assembly homepage is http://www.ai.org/legislative/. No fee is charged for viewing, downloading, or printing minutes from the Internet.

Mr. Sheldrake began by noting that in May of this year the IFPI published a report examining the performance of Indiana's public pension funds since the 1996 amendment to the Indiana Constitution authorizing investment in equities. (See Exhibit A, the Indiana Fiscal Policy Institute's report "Indiana Pension Funds: Expanding the Impact of Equity.")

According to the report, from May 1997 through December 31, 1999, the annualized return of the Public Employee's Retirement Fund's (PERF's) equity investment was 24.2%, only slightly behind the 25.5% annualized return of the S&P 500 during that same period. The annualized return on the equity investments of the Teachers' Retirement Fund (TRF) from August 1998 (when it began investing in equities) through December 31, 1999, was 28.9%, ahead of the S&P 500's annualized return of 21.3% during that period.

Mr. Sheldrake stated that Indiana has benefitted from the 1996 Constitutional change and the investment of PERF and TRF assets in equities. According to the IFPI's report, if the pension funds' assets had still been invested entirely in bonds over the past three years, their earnings would been approximately $1.874 billion dollars less.

Mr. Sheldrake explained that the IFPI's report also addressed the question of whether other asset classes could increase the pension funds' returns and reduce their risk. He said that in its study of other public pension funds, the IFPI found that private equity is the most popular type of asset class that was not invested in by PERF or TRF. Mr. Sheldrake noted that 37 states have allocated a portion of their pension fund assets to private equity investments. According to the report, on December 31, 1998, the average state pension fund had approximately 2.2% of its assets invested in private equity.

Mr. Sheldrake then described the IFPI's finding that over the period 1969 - 1998, the annualized return of private equity investments was 17.2%, higher than returns on investments in large company stocks (12.7%), small company stocks (12.1%), and long-term corporate bonds (9.1%) during the same period. He stated that the report shows that it makes sense for Indiana's pension funds to invest in private equity, as this should increase their return while lowering overall risk. Mr. Sheldrake commented that if a pension fund were to move into private equity investments, it should do so slowly. He pointed to the "best practices" listed in the IFPI's report: (1) commit to private equity for the long term; (2) use external expertise; (3) develop internal expertise; and (4) put fiduciary duty first in developing the private equity program. The IFPI report also described indirect economic benefits that may result from the investment in private equity. Mr. Sheldrake cited a Milken Institute study showing the importance of venture capital financing to a region's technology industry.

Senator Larry Lutz asked Mr. Sheldrake whether private equity investments involved higher risk. Mr. Sheldrake explained that because private equity has a low correlation with public equity, adding it to a portfolio may lower the overall risk, even though private equity as a class may be riskier than public equity.

Senator Tom Weatherwax asked Mr. Sheldrake if the public pension funds could invest in private equity without legislative authorization from the General Assembly. Mr. Sheldrake replied that the funds could do so. In answer to another question from Senator Weatherwax, Mr. Sheldrake stated that in any program of investment in private equity, the funds must maintain their focus on fiduciary duty to their members. Mr. William Gettings, Jr., asked Mr. Sheldrake if he had any recommendations on how the funds' boards of trustees should proceed in a program of investing in private equity. Mr. Sheldrake replied that a "fund of funds" strategy might be appropriate in the short-term.

II. Pension Relief Fund Issues

Representative Kromkowski then recognized Mr. Doug Todd of McCready and Keene, actuaries for PERF, and Ms. Mary Beth Braitman of Ice Miller, outside counsel for PERF, for a discussion of pension relief issues.

Mr. Todd began by explaining the current projections of distributions that will be paid from the state Pension Relief Fund. (See charts in Exhibit B, "Municipal Police and Fire Accrued Liability-to-Levy Comparisons.") Mr. Todd noted that under the current distribution statutes there will be a funding shortfall of approximately $36 million (2001 present value) beginning around 2021, and the cities will have to make up this amount. He then discussed a chart showing the ratio of cities' accrued liability under the old police and firefighter plans to the cities' maximum property tax levies. He noted that Indianapolis' ratio of accrued liability to maximum levy is approximately 610% and that the ratio for the state as a whole is almost 350%. Ms. Braitman then explained to the Commission a report describing the percentage of municipal pension benefits paid by pension relief. (See Exhibit C, "Percent of Pension Benefits Covered by Pension Relief in 1999.") According to Ms. Braitman, 48.1% of the old police and firefighter pension benefits (including benefits of so-called "convertees") were paid from pension relief distributions in 1999.

Mr. Todd then described a chart (contained in Exhibit B) showing what funding would be necessary to enable Pension Relief Fund distributions to cover 50% of benefit distributions for old plan members. According to Mr. Todd, this would require an additional $104 million (2001 present value) from the Pension Relief Fund plus an additional $305 million (2001 present value) beginning in 2018. Senator Weatherwax asked if cities could earmark additional money for future pension needs. Ms. Braitman commented that cities with the greatest future needs are often the ones facing the greatest current burden in paying benefits. (See also Exhibit D, "Number of Cities Receiving Pension Relief by % (1999).")

III. Police and Firefighter Pensions

Representative Kromkowski then recognized Representative Scott Pelath for comments concerning police and firefighter pensions. Representative Pelath explained that the pensions for retiring police officers and firefighters are based on the salary of first class officers and are not based on their own ranks at the time of retirement.

Representative Kromkowski recognized Mr. Jacobucci, who commented that, for example, a retiring captain's salary should be based on a captain's salary rather than the salary of a first class officer. He stated that sheriffs and state police officers do use their best salary years when their pensions are calculated. Representative Pelath asked the Commission to determine how much it would cost to establish a retirement system for police officers and firefighters based on the members' own salaries.

IV. Prescription Drugs for Retirees

Representative Kromkowski then recognized Ms. Kathleen Gifford, Chair of the Indiana Prescription Drug Advisory Committee. Ms. Gifford briefly described to the Commission the recommendations made by the Advisory Committee. She first noted that senior citizens in Indiana spend approximately $1 billion per year on prescription drugs, and she commented that the problem required a national solution and action by the United States Congress.

She then explained that the Advisory Committee had recommended that the State should implement a two-phase senior citizen prescription drug program: (1) Phase I would be a refund program for costs incurred in purchasing the drugs; and (2) Phase 2 would be a point-of-sale program. The recommendations also provided that the program should be targeted at low-income seniors (at or below 135% of the federal poverty level). (See Exhibit E, FSSA cover letter and Indiana Prescription Drug Advisory Committee Recommendations.)

Mr. Ed Gohmann, attorney for the Commission, explained the provisions of PD 3196, concerning prescription drug coverage. According to Mr. Gohmann, the draft, which is based on HB 1190 from the 2000 Session, would require the state to offer coverage for prescription drugs to retired state employees who are not wholly covered for prescription drugs under another plan of assistance or insurance. Under the provisions of the draft, a retired state employee who participated in the prescription drug plan would be required to pay one-half of the cost of the premium. Representative Kromkowski requested staff to determine the cost of a prescription drug program that required state retirees to pay the same amount for prescription drugs as active employees. (See Exhibit F, PD 3196.)

V. Health Insurance for Retired State Employees

Mr. Gohmann then explained the provisions of PD 3195, concerning retiree health insurance. According to Mr. Gohmann, the draft, which is based on a 1999 bill, would require the state to pay the employer's share of the health insurance premium for retired state employees who are not eligible for Medicare coverage and who meet certain other requirements. The draft would authorize the state to elect to pay any part of the retired employee's share of the premium. (See Exhibit G, PD 3195.)

Representative Kromkowski then recognized Mr. Bob Brown, representing the American Federation of State, County, and Municipal Employees (AFSCME). According to Mr. Brown, 19 states provide fully-paid health insurance for their retired employees, and Indiana and Nebraska are the only two states that do not allow persons over age 65 to participate in state health insurance plans. Mr. Brown commented that some people cannot retire because they are unable to afford health insurance. Mr. Brown distributed to the Commission a document showing the costs of retiree health insurance in the various states. (See Exhibit H, AFSCME information concerning health insurance.)

Representative Kromkowski then recognized Ms. Lynn Hajak, a state employee from South Bend. Ms. Hajak stated that many state retirees receive fairly low pensions, and after deducting the costs for health insurance they have very little money left over for living expenses. She explained that she is assisting in the gathering of a petition requesting affordable health insurance to be made available to retired state employees. Ms. Hajak noted that she also supports an increase in the multiplier used in determining pensions for retired state employees.

Mr. Larsen of the Indiana State Employee Association then commented that the state achieves a certain amount of savings when an experienced employee retires and is replaced by a less experienced employee who is generally paid less than the retiring employee. He stated that this savings could be used to pay for retiree health insurance. He noted that he also supports an increase in the pension multiplier. Mr. Mark Shublak, representing the State Welfare Administrators Association, also briefly spoke on the issue.

VI. Judges' Retirement Fund

Representative Kromkowski next recognized Judge Tom Milligan, Judge of the Montgomery Circuit Court and Vice President of the Indiana Judges Association. Judge

Milligan explained that the Indiana Judges Association is requesting re-approval of the two proposals previously recommended by the Commission: (1) requiring the benefit paid to members under the 1985 judges benefit system to be increased by the same percentages as benefits are increased for PERF members; and (2) providing that magistrates are members of the 1985 judges benefit system, rather than being members of PERF.

VII. Prosecuting Attorney Retirement Fund

Representative Kromkowski then recognized Ms. Deborah Daniels, who distributed a copy of HB 1025 from the 2000 Session, which included Prosecuting Attorneys Retirement Fund (PARF) proposals that had been recommended by the Commission during the 1999 interim. (See Exhibit I, HB 1025-2000). Ms. Daniels also distributed to the Commission a chart contrasting the major plan provisions of PARF and the Judges Retirement Fund. (See Exhibit J.)

Mr. John Larson, Warren County Prosecuting Attorney, briefly described the proposals that prosecuting attorneys wished to again raise before the Commission: (1) provide for vesting for prosecutors at eight years, rather than ten; (2) increase the percentage multipliers used in determining prosecutor pensions; (3) reduce the early retirement "reduction factor"; (4) establish a cost-of-living adjustment (COLA) tied to PERF COLAs; and (5) repeal the requirement that members continue to contribute to PARF after 22 years of service. (See Exhibit K, Mr. Larson's written testimony.)

VIII. PERF \ TRF Benefit Structure

Representative Kromkowski recognized Ms. Braitman for a discussion of PERF and TRF benefits. Ms. Braitman began by explaining that PERF and TRF are unique among public pension plans because the employee contributions of a member provide a benefit independent of the employer-financed pension. She noted that Commission members and others had expressed an interest in changing benefits to help long-term, lower-paid employees. Ms. Braitman then briefly described a chart comparing public pension benefits provided by the various states. (See Exhibit L, "Benefit Comparisons for Public Employees.")

She explained that to provide an accurate true comparison between Indiana pension benefits and those in other states, it is necessary to consider Indiana's annuity savings account benefit. Ms. Braitman stated that Indiana's "multiplier equivalent" (which includes both the pension portion and the annuity savings account portion) could vary widely depending on the earnings of members' annuity savings accounts. She then described the multiplier equivalents that would result from various rates of return on annuity savings accounts. (See Exhibit M, "Indiana Public Employees Retirement Fund Benefit Levels and Multiplier Equivalents for Different ASA Earnings Assumptions.") Ms. Braitman said that 23 states provide a minimum retirement benefit level, based on a number of different factors, such as a flat amount or a number of years of service. (See Exhibit N, "Minimum Guaranteed Benefits at Normal Retirement.") Ms. Braitman also distributed to the Commission a chart showing the number of retired PERF and TRF members who receive various amounts of benefits. (See Exhibits O and P.) She pointed out that 1,901 PERF members receive a monthly benefit of less than $100, and that 576 TRF members receive a monthly benefit of less than $100. Ms. Braitman stated that an increase in the pension multiplier would have a large fiscal impact, but that perhaps instituting a minimum benefit could help the most needy at a relatively low cost.

Mr. Phil Conklin of the Retired Indiana Public Employees Association (RIPEA) was then recognized by Representative Kromkowski. Mr. Conklin thanked the Commission and members of PERF for addressing the issue of low pension benefits. He gave a number of examples of retired public employees who are receiving low benefits and face high health insurance costs. Mr. Conklin noted that the PERF benefit structure has not changed significantly since PERF's inception in 1945, while other costs such as health care have increased dramatically.

Mr. Conklin suggested that the benefit structure could perhaps be changed to provide a minimum benefit based on some dollar amount for each year of service, or perhaps longer-serving retired employees could receive "bonus" years of service for purposes of calculating their pensions. (See Exhibit Q, RIPEA Memorandum.)

IX. PERF and TRF Earnings Limitation

Ms. Braitman then addressed the issue of the PERF and TREF earnings limitation. She stated that Indiana law specifies that a PERF or TRF member who is receiving pension benefits and is then reemployed in a PERF or TRF covered position may continue receiving benefits until the member earns more than the Social Security normal retirement age earnings limit. Ms. Braitman explained that in April of 2000, federal legislation was enacted that eliminates this Social Security earnings limitation beginning with the month a person attains full retirement age (currently age 65), and that because the federal act eliminated the earnings limit that is referenced by Indiana law, there is no earnings limit for PERF and TRF retirees who return to work in PERF or TRF covered positions.

Ms. Braitman then described possible approaches that the General Assembly could take in addressing the issue. (See Exhibit R, "Questions for PMOC - Decision Making Process for Earnings Limitation Issue.") She stated that the Commission would first have to decide if it wished to reimpose an earnings limitation. She commented that it would be costly if a limit were not put back in place, noting that high-end estimates predict a cost equal to a additional 2% of payroll.

Ms. Braitman then described the other questions that the Commission would have to address on the issue: (1) if an earnings limitation were enacted, would it apply to all retirees or only to early retirees? (2) if the Commission decides not to reestablish an earnings limitation, what benefit should retirees earn during their period of reemployment; and (3) if the Commission decides not to reestablish an earnings limitation, what choices should a reemployed retiree have concerning the payment option for his or her benefits.

Representative Kromkowski stated that regardless of the options chosen by the Commission, no retirees should receive lower benefits or have a lower earnings limitation than before the repeal of federal law. In answer to a question from Senator Joseph Harrison, Ms. Braitman explained that a PERF or TRF member currently has a limited ability to change the member's payment option if the member's family situation changes. Ms. Jodie Woods, representing the Indiana Association of Cities and Towns, commented that municipalities would consider it an unfunded mandate if they were required to pay additional amounts as employers because of an absence of an earnings limitation.

X. Administrative Issues

Representative Kromkowski then recognized Mr. Gohmann for a discussion of PD 3284, concerning pension fund administrative issues. (See Exhibit S.) Mr. Gohmann explained that the draft included the following provisions: (1) specifies that the additional annuity savings account contributions that may be made by a PERF member or a TRF member may not exceed 10% of the member's compensation; (2) provides that a governing body of a unit that is participating in PERF is not required to request a survey of the estimated cost of participation, and the PERF board is not required to provide an estimate of the costs of participation, when the unit adopts a resolution or ordinance providing that additional classifications of employees will become members of the fund; (3) specifies that an employer may pay all or a part of the annuity savings account contribution for employees (other than state employees) who are members of PERF (current law authorizes a PERF employer other than the state to pay either none or all of the contribution, but does not allow for partial payment); (4) provides that persons employed by TRF are members of TRF; (5) provides that even if a firefighter is age 36 years or older, the firefighter may be reappointed as a member of a department if the firefighter can complete 20 years of service before reaching age 60; and (5) corrects cross references to provisions related to police and firefighter disability benefits.

Representative Kromkowski then noted that an issue raised by Senator Jackman concerning teacher retirement benefits would be addressed at PMOC's next meeting. The next meeting was set for October 4 at 10:00 a.m. in the State House. There being no further business, Representative Kromkowski adjourned the meeting at approximately 12:45 p.m.